

BAHRAIN

The Department of State submitted this report to the Senate Committees on Foreign Relations and on Finance and to the House Committees on Foreign Affairs and on Ways and Means, on January 31, 1999.

Key Economic Indicators
(Millions of U.S. Dollars unless otherwise indicated)

	1996	1997	1998	1/
<i>Income, Production and Employment:</i>				
GDP (current)	5,790	6,080	6,262	
Nominal GDP Growth (pct)	5.9	5.0	3.0	
GDP by Sector:				
Agriculture	58	58	58	
Manufacturing	1,043	1,050	1,081	
Services	1,157	1,157	1,203	
Government	991	991	942	
Per Capita GDP (US\$) 2/	9,666	9,806	9,769	
Labor Force (1,000s)	231	235	240	
Unemployment Rate	15	15	15	
<i>Money and Prices (annual percentage growth):</i>				
Money Supply (M2)	2.9	8.2	8.9	
Exchange Rate (US\$/BD)	2.65	2.65	2.65	
<i>Balance of Payments and Trade:</i>				
Total Exports FOB 3/	4,681	4,310	3,217	
Exports to U.S.	124	126	172	
Total Imports CIF	4,262	3,857	3,202	
Imports from U.S.	244	266	299	
Trade Balance	419	453	15	
Trade Balance with U.S. 4/	-120	-140	-127	
External Public Debt	N/A	N/A	N/A	
Current Account Deficit/GDP (pct)	0	0	0	
Debt Service Payments/GDP (pct)	N/A	N/A	N/A	
Gold and Foreign Exchange Reserves	935	1,035	1,090	
Aid from U.S.	0	0	0	
Aid from All Other Sources	50.0	50.0	50.0	

1/ 1998 figures are all estimates based on data available in October.

2/ Current prices, based on population projections.

3/ Exports include transshipment, which accounts for 14 percent of non-oil exports from Bahrain.

4/ Figures reflect merchandise trade.

1. General Policy Framework

Although the Government of Bahrain has controlling interest in many of the island's major industrial establishments, its overall approach to economic policy, especially those policies that affect demand for U.S. exports, can best be described as *laissez faire*. Except for certain basic foodstuffs, the price of goods in Bahrain is determined by market forces, and the importation and distribution of foreign commodities and manufactured products is carried out by the private sector. Owing to its historical position as a regional trading center, Bahrain has a well developed and highly competitive mercantile sector in which products from the entire world are represented. Import duties are assessed at a ten percent rate on most products. The Bahraini Dinar is freely convertible, and there are no restrictions on the remittance of capital or profits. Bahrain does not tax either individual or corporate earnings, other than petroleum revenues.

Over the past two decades, the government has encouraged economic diversification by investing directly in such basic industries as aluminum smelting, petrochemicals, and ship repair, and by creating a secure regulatory framework that has fostered Bahrain's development as a regional financial and commercial center. Despite diversification efforts, the oil and gas sector remains the cornerstone of the economy. Oil and gas revenues constitute over 55 percent of governmental revenues, and oil and related products account for about 80 percent of the island's exports. Bahrain's oil production amounts to about 40,000 barrels a day (b/d), and it receives oil revenues from the 140,000 b/d produced from Saudi Arabia's Abu Sa'fa offshore oil field.

The budgetary accounts for the central government are prepared on a biennial basis. The budget for 1997 and 1998 was approved in December 1996, and the government currently is preparing the 1999-2000 budget. Budgetary revenues consist primarily of receipts from oil and gas, supplemented by fees and charges for services, customs duties, and investment income. Bahrain has no income taxes and thus does not use its tax system to implement social or investment policies. Budget figures for 1998 project a \$198 million deficit which will be financed through the issuance of three-month and six-month treasury bills to domestic banks.

The instruments of monetary policy available to the Bahrain Monetary Agency (BMA) are limited. Treasury bills are used to regulate dinar liquidity positions of the commercial banks. Liquidity to the banks is provided now through secondary operations in treasury bills, including: (a) discounting treasury bills; and (b) sales by banks of bills to the BMA with a simultaneous agreement to repurchase at a later date ("repos"). Starting in 1985, the BMA imposed a reserve requirement on commercial banks equal to five percent of dinar liabilities. Although the BMA has no legal authority to fix interest rates, it has published recommended rates for Bahraini Dinar deposits since 1975. In 1982, the BMA instructed the commercial banks to observe a maximum margin of one percent over their cost of funds, as determined by the recommended deposit rates, for loans to prime customers. In August 1988, special interest rate ceilings for consumer loans were introduced. In May 1989, the maximum prime rate was abolished, and in February 1990,

new guidelines permitting the issuance of dinar certificates of deposit (CDs) at freely negotiated rates for any maturity from six months to five years were published.

2. Exchange Rate Policies

Since December 1980, Bahrain has maintained a fixed relationship between the dinar and the dollar at the rate of one dollar equals 0.377 BD. Bahrain maintains a fully open exchange system free of restrictions on payments and transfers. There is no black market or parallel exchange rate.

3. Structural Policies

As a member of the six-nation Gulf Cooperation Council (GCC), Bahrain participates fully in GCC efforts to achieve greater economic integration among its member states (Kuwait, Oman, Qatar, Saudi Arabia, the United Arab Emirates, and Bahrain). In addition to according duty-free treatment to imports from other GCC states, Bahrain has adopted GCC food product labeling and automobile standards. Efforts are underway within the GCC to enlarge the scope of cooperation in fields such as product standards and industrial investment coordination. In recent years, the GCC has focused its attention on negotiating on a free trade agreement with the European Union. If these negotiations are successfully concluded, such an agreement could have a long-term adverse impact on the competitiveness of U.S. products within the GCC, including Bahrain. Bahrain is an active participant in the ongoing U.S.-GCC economic dialogue. For the present, U.S. products and services compete on an equal footing with those of other non-GCC foreign suppliers. Bahrain still officially participates in the primary Arab League economic boycott against Israel, but does not observe secondary and tertiary boycott policies against third-country firms having economic relationships with Israel.

With the exception of a few basic foodstuffs and petroleum product prices, the government does not attempt to control prices on the local market. Because most manufactured products sold in Bahrain are imported, prices basically depend upon the source of supply, shipping costs, and agents' markups. Since the opening of the Saudi Arabia-Bahrain causeway in 1985, local merchants have been less able to maintain excessive margins, and as a consequence, prices have tended to fall toward the levels prevailing in other GCC countries. Consumer competition is likely to increase further as the impact of the 1998 Agency Law revision takes effect. The revised law abolishes agency monopolies, caps commissions at five percent, and provides for the phasing out of commissions entirely over the next five years.

Bahrain is essentially tax-free. The only corporate income tax in Bahrain is levied on oil, gas, and petroleum companies. There is no individual income tax, nor does the island have any value-added tax, property tax, production tax or withholding tax. Bahrain has customs duties and a few indirect and excise taxes, which include a tax on gasoline, a ten percent levy on rents paid by residential tenants, a 12.5 percent tax on office rents, and a 15 percent tax on hotel room rates.

4. Debt Management Policies

The government follows a policy of strictly limiting its official indebtedness to foreign financial institutions. To date, it has financed its budget deficit through local banks. In April 1998, Bahrain launched its first bond issue (BD 40 million, equivalent to \$107 million). It was well received. The government has no plans for a second issue at this time. Bahrain has no International Monetary Fund or World Bank programs.

5. Aid

Bahrain receives assistance in the form of project grants from Saudi Arabia, Kuwait, and the United Arab Emirates. On April 1, 1996, Saudi Arabia began giving Bahrain 100 percent of the revenue from the 140,000 b/d of oil produced from the offshore Abu Sa'fa field, a major source of funding for the government's budget.

6. Significant Barriers to U.S. Exports

Standards: Processed food items imported into Bahrain are subject to strict shelf life and labeling requirements. Pharmaceutical products must be imported directly from a manufacturer that has a research department and must be licensed in at least two other GCC countries, one of which must be Saudi Arabia.

Investment: The government actively promotes foreign investment and permits 100 percent foreign ownership of new industrial enterprises and the establishment of representative offices or branches of foreign companies without local sponsors. Other commercial investments are made in partnership with a Bahraini national controlling 51 percent of the equity. Except for citizens of Kuwait, Saudi Arabia, and the United Arab Emirates, foreign nationals must lease rather than purchase land in Bahrain. The government encourages the employment of local nationals by setting local national employment targets in each sector and by restricting the issuance of expatriate labor permits, although a sizable expatriate labor force continues to work in Bahrain.

Government Procurement Practices: The government makes major purchasing decisions through the tendering process. For major projects, the Ministries of Works and Agriculture, and of Power and Water, extend invitations to selected, prequalified firms. Construction companies bidding on government construction projects must be registered with the Ministry of Works and Agriculture. Smaller contracts are handled by individual ministries and departments and are not subject to prequalification.

Customs Procedures: The customs clearance process is used to enforce the primary boycott of Israel, insofar as it is enforced. While goods produced by formerly blacklisted firms may be subjected to minor delays, the secondary and tertiary boycotts are no longer used as the basis for denying customs clearance, and the process of removing firms from the blacklist has

become routine, upon application by the subject firm. Bahraini customs also enforces the Commercial Agencies Law. Goods manufactured by a firm with a registered agent in Bahrain may be imported by that firm's agents or, if by a third party, upon payment of a commission to the registered agent. This arrangement is being phased out (see above).

7. Export Subsidies Policies

The government provides indirect export subsidies in the form of preferential rates for electricity, water, and natural gas to selected industrial establishments. The government also permits the duty-free importation of raw material inputs for incorporation into products for export and the duty-free importation of equipment and machinery for newly established export industries. The government does not specifically target subsidies to small businesses.

8. Protection of U.S. Intellectual Property

Bahrain is a signatory of the GATT Uruguay Round and World Trade Organization (WTO) agreements, including the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPs), and is obligated to bring its laws and enforcement efforts into TRIPs compliance by January 1, 2000. In February 1995, Bahrain joined the World Intellectual Property Organization (WIPO), and it signed the Berne Convention for the Protection of Literary and Artistic Works, and the Paris Convention for the Protection of Industrial Property on October 29, 1996.

In April 1998, the U.S. Trade Representative maintained Bahrain on the Special 301 "Watch List" for failure to provide adequate and effective enforcement of IP laws and regulations relating to copyrighted and trademarked goods. The government's 1993 Copyright Protection Law is aggressively enforced but is incompatible with the Berne Convention and TRIPs. Since the Special 301 announcement, Bahrain has forcefully cracked down on audio visual copyright piracy in the last year, and these efforts have been sustained and expanded to software. Sound recording piracy, however, remains a major problem. Industry associations have applauded the government's improvements in IPR protection, but have also stressed the importance of the government revising its laws and increasing penalties against violators.

9. Worker Rights

a. The Right of Association: The partially suspended 1973 constitution recognizes the right of workers to organize, but western-style trade unions do not exist in Bahrain, and the government does not encourage their formation. Article 27 of Bahrain's Constitution states: "Freedom to form associations and trade unions on national bases and for lawful objectives and by peaceful means shall be guaranteed in accordance with the conditions and in the manner prescribed by the law. No person shall be compelled to join or remain in any association or union."

In response to labor unrest in the mid-1950's and in 1965 and 1974, the government passed a series of labor regulations that, among other things, allow the formation of elected workers' committees in larger Bahraini companies. Worker representation in Bahrain today is based on a system of Joint Labor-Management Committees (JLCs) established by ministerial decree. Between 1981 and 1984, 12 JLCs were established in the major state-owned industries. In 1994, four new JLCs were established in the private sector, including one in a major hotel. In September 1998, three more JLCs were created, bringing the total number in Bahrain to 19.

b. The Right to Organize and Bargain Collectively: Bahrain's Labor Law neither grants nor denies workers the right to organize and bargain collectively. While the JLCs described above are empowered to discuss labor disputes, organize workers' services, and discuss wages, working conditions, and productivity, the workers have no independent, recognized vehicle for representing their interests on these or other labor-related issues.

c. Prohibition of Forced or Compulsory Labor: Forced or compulsory labor is prohibited in Bahrain, and the Labor Ministry is charged with enforcing the law. The press often performs an ombudsman function on labor problems, reporting instances in which private sector employers occasionally compelled foreign workers from developing countries to perform work not specified in their contracts, as well as Labor Ministry responses. Once a complaint has been lodged by a worker, the Labor Ministry opens an investigation and takes action.

d. Minimum Age for Employment of Children: The minimum age for employment is 14. Juveniles between the ages of 14 and 16 may not be employed in hazardous conditions or at night, and may not work over six hours per day or on a piecework basis. Child labor laws are effectively enforced by Labor Ministry inspectors in the industrial sector; child labor outside that sector is less well monitored, but it is not believed to be significant outside family-operated businesses.

e. Acceptable Conditions of Work: Minimum wage scales, set by government decree, exist for public sector employees and generally afford a decent standard of living for workers and their families. Current minimum wage for the public sector is 236.60 dollars (91 BD) a month. Wages in the private sector are determined on a contract basis. For foreign workers, employers consider benefits such as annual trips home, housing, and education bonuses part of the salary.

Bahrain's Labor Law mandates acceptable working conditions for all adult workers, including adequate standards regarding hours of work (maximum 48 hours per week) and occupational safety and health. Complaints brought before the Labor Ministry that cannot be settled through arbitration must, by law, be referred to the Fourth High Court (Labor) within 15 days. In practice, most employers prefer to settle such disputes through arbitration, particularly since the court and labor law are generally considered to favor the worker.

f. Rights in Sectors with U.S. Investment: The company law does not discriminate at all against foreign-owned companies. Workers at all companies with U.S. investment enjoy the same rights and conditions as other workers in Bahrain.

**Extent of U.S. Investment in Selected Industries -- U.S. Direct Investment Position Abroad
on an Historical Cost Basis -- 1997**

(Millions of U.S. Dollars)

Category	Amount
Petroleum	-36
Total Manufacturing	-7
Food & Kindred Products	(1)
Chemicals & Allied Products	0
Primary & Fabricated Metals	(1)
Industrial Machinery and Equipment	(1)
Electric & Electronic Equipment	0
Transportation Equipment	0
Other Manufacturing	(1)
Wholesale Trade	(2)
Banking	(1)
Finance/Insurance/Real Estate	-9
Services	(1)
Other Industries	(1)
TOTAL ALL INDUSTRIES	-80

(1) Suppressed to avoid disclosing data of individual companies.

(2) Less than \$500,000 (+/-).

Source: U.S. Department of Commerce, Bureau of Economic Analysis.